*Spahr v. Secco**

I. INTRODUCTION

Arbitrability is the issue of whether the parties to a contract agreed to arbitrate a particular claim and are therefore precluded from resolving that claim in court.[1] The Federal Arbitration Act (FAA) supports a strong policy favoring the use of arbitration.[2] The FAA dictates that on motions to compel arbitration, the court, "upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue," shall order the parties to arbitration, according to the terms of their agreement.[3] However, "[i]f the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof."[4]

In the 1967 decision of *Prima Paint Corp. v. Flood & Conklin Manufacturing*,[5] the Supreme Court made it extremely difficult for any party to avoid arbitration. The Supreme Court held that a court "may consider *only* issues relating to the making and performance of the agreement to arbitrate."[6] The *Prima Paint* Court established the doctrine of separability, ruling that to avoid arbitration, claims of fraud in the inducement must specifically go "to the 'making' of the agreement to arbitrate" itself, not to the entire agreement generally.[7] From 1967 until recently, courts consistently applied the *Prima Paint* ruling to almost all voidable contracts.[8]

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* Spahr v. Secco, 330 F.3d 1266 (10th Cir. 2003).

[1] *See* Carbajal v. Household Bank, No. 00 C 0626, 2003 U.S. Dist. LEXIS 16458, at *15-16 (N.D. Ill. Sept 18, 2003) (ruling that contractual language stating that "any dispute" must go to arbitration required the plaintiff to arbitrate his fraud claim).

[2] Southland Corp. v. Keating, 465 U.S. 1, 10, 16 (1984) (citing FAA legislative history to support a ruling that Congress could preempt both state substantive and procedural law by requiring state courts to enforce the FAA).

[3] 9 U.S.C. § 4 (2002).

[4] *Id.*

[5] Prima Paint Corp. v. Flood & Conklin Mfg., 388 U.S. 395, 404 (1967).

[6] *Id.* (emphasis added).

[7] *Id.* at 403–04. The doctrine of separability is the rule that requires an arbitration agreement and the rest of a single contract to be treated as two distinct agreements. Richard C. Reuben, *First Options, Consent to Arbitration, and the Demise of Separability: Restoring Access to Justice for Contracts with Arbitration Provisions*, 56 SMU L. REV. 819, 838 (2003).

[8] *See, e.g.*, Jeske v. Brooks, 875 F.2d 71, 75 (4th Cir. 1989) (holding that arbitrators are to decide unconscionability and lack-of-consideration claims that challenge the entire contract); Unionmutual Stock Life Ins. Co. v. Beneficial Life Ins. Co., 774 F.2d 524, 529

However, in the 2003 case of *Spahr v. Secco*, the Tenth Circuit Court of Appeals held that mental incapacity claims must be decided by a court *before* going to arbitration.[9] This decision directly conflicts with a recent Fifth Circuit Court of Appeals decision, which held that courts cannot consider a mental incapacity defense if the parties agreed to submit all disputes to arbitration.[10] Because of *Spahr*'s divergence from the voidable contracts rule and its direct conflict with the Fifth Circuit's recent decision, it may prove to be a milestone decision in the law on arbitrability.

II. FACTS AND PROCEDURAL HISTORY

In 1995, William Spahr opened an investment account at U.S. Bancorp Investments, Inc. (hereinafter "U.S. Bancorp") through its employee, Melissa Secco.[11] In opening the account, Spahr signed a contract that contained an arbitration agreement for "any controversy" relating to the account.[12] At that time, and throughout his dealings with Secco, Spahr was unable to manage his financial affairs effectively, because he had dementia and Alzheimer's disease.[13]

In 1999, Spahr filed suit against Secco and U.S. Bancorp alleging that Secco "exploited hi[s] mental deficiencies and finagled him out of large amounts of money and real estate" and that U.S. Bancorp was negligent in employing Secco in her particular position of trust.[14] U.S. Bancorp filed a motion to compel arbitration.[15] The District Court of Colorado denied U.S. Bancorp's motion, finding that the parties' agreement was not legally

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(1st Cir. 1985) (holding that arbitrators are to decide mutual mistake and frustration-of-purpose defenses that do not go specifically to an arbitration agreement); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Haydu, 637 F.2d 391, 398 (5th Cir. 1981) (holding that arbitrators are to decide duress and unconscionability defenses that fail to challenge the arbitration clause itself); Commonwealth Edison Co. v. Gulf Oil Corp., 541 F.2d 1263, 1271 (7th Cir. 1976) (holding that arbitrators are to decide frustration-of-performance claims that challenge the entire contract).

[9] Spahr v. Secco, 330 F.3d 1266, 1273 (10th Cir. 2003).

[10] Primerica Life Ins. Co. v. Brown, 304 F.3d 469, 472 (5th Cir. 2002).

[11] *Spahr*, 330 F.3d at 1268.

[12] *Id.* Spahr also signed two subsequent agreements with arbitration clauses. *Id.* at 1268 n.1. However, both the district and appellate courts found these subsequent agreements to be inapplicable to the claims at issue. *Id.* at 1268–69, 1274–75.

[13] *Id.* at 1268.

[14] *Spahr*, 330 F.3d at 1268. Spahr claimed that Secco was "'legendary' . . . for convincing elderly men to loan her money in exchange for sex," and therefore U.S. Bancorp was negligent for employing her in the position she held. *Id.*

[15] *Id.* Secco requested to join U.S. Bancorp's motion but was denied. *Id.* at 1268–69.

enforceable because of Spahr's mental incapacity.[16] U.S. Bancorp appealed, arguing that Spahr's mental incapacity claim went to the entire contract generally, and not to the arbitration clause itself.[17]

III. THE COURT'S HOLDING AND REASONING

The Tenth Circuit upheld the district court's decision, holding that Spahr's mental capacity defense went both to the entire contract and to the specific arbitration agreement.[18] The court based its holding on the argument that, unlike fraud in the inducement, mental incapacity can never be said to affect only a specific part of an agreement without also affecting the entire agreement.[19]

A. *The* Spahr *Court's Distinction of* Prima Paint

In *Prima Paint*, the Supreme Court ruled that an arbitration agreement is to be considered separate from the rest of the contract in which it is found, and the arbitration agreement itself must be induced by fraud in order to avoid arbitration.[20] The Tenth Circuit viewed such separation reasonable only because of the possibility that a party either could be fraudulently induced to make a contract that just happens to contain an arbitration agreement, or the party could be fraudulently induced to make the arbitration agreement itself.[21] In dicta, the circuit court argued that the possibility of treating the arbitration agreement separate from the rest of the contract could not occur with mental incapacity, because mental incapacity is based on a party's status, which is relatively constant. Fraud in the inducement, on the other hand, is based on a party's conduct, which can vary when making agreements.[22]

B. *The* Spahr *Court's Lack of Supporting Precedent*

The *Spahr* court arrived at its holding despite the fact that it did not cite to any prior decisions over the past thirty-six years to support its ruling or

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[16] *Id.* at 1268.

[17] *Id.* at 1270.

[18] *Id.* at 1273.

[19] *Id.*

[20] *Prima Paint*, 388 U.S. at 402–04.

[21] *Spahr*, 330 F.3d at 1273.

[22] *Id.* at 1273 n.8 (discussing the status-conduct distinction, referring to E. ALLEN FARNSWORTH, FARNSWORTH ON CONTRACTS § 4.1, at 419–20 (2d ed. 1998)).

analysis.[23] Additionally, the court recognized that it failed to follow the popular distinction between void and voidable contracts, stating that this rule did not apply to mental incapacity challenges.[24]

C. *The* Spahr *Court's Reasoning Compared to the* Primerica *Court's Reasoning*

While the *Spahr* court's analysis is based almost exclusively on the logic that arbitration clauses may not be separable from an overall contract in terms of certain defenses to the contract,[25] other courts have stayed much closer to the "strong national policy favoring arbitration."[26] In *Primerica*, the Fifth Circuit reasoned that analyzing a capacity defense would require the court to address the merits of the underlying dispute, instead of only considering the "making" of the agreement and resolving all doubts in favor of arbitration, as required by the FAA and *Prima Paint*.[27] As with many other courts that have addressed the arbitrability of potentially voidable contracts, the *Primerica* court found that a party must make a specific challenge to the arbitration agreement itself in order to avoid arbitration—even for incapacity challenges.[28]

While the majority opinion in *Primerica* is representative of many current arbitrability decisions, the concurrence in *Primerica* offers an analysis not addressed by either the *Primerica* majority or the *Spahr* court.[29] Recognizing that Mr. Brown, the plaintiff seeking to avoid arbitration in *Primerica*, had been "profoundly retarded since birth," the concurrence by Judge Dennis considered the requirements for a court to vacate an arbitration

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[23] *See Spahr*, 330 F.3d at 1272. In fact, the court cites five decisions in its opinion, all of which hold that voidable defenses, including mental incapacity, are for arbitrators to decide. *Id.*

[24] *Id.* Under the popular void-voidable distinction, void contract claims are decided by courts, while voidable contract claims are sent to arbitration. Sarah Cole, Commercial and Labor Arbitration 29 (Winter 2003) (unpublished manuscript, on file with author). This distinction is based on the view that a void contract never existed to begin with, so there never could have been a valid agreement to arbitrate, whereas voidable contracts are valid, even though they may be voided later by one of the parties. *Id.*

[25] *See Spahr*, 330 F.3d at 1272–73.

[26] Primerica Life Ins. Co. v. Brown, 304 F.3d 469, 471 (5th Cir. 2002). The Fifth Circuit cited Southland Corp. v. Keating, 465 U.S. 1, 10 (1984), which noted that Congress, in enacting the FAA, "declared a national policy favoring arbitration." *Id.*

[27] *Primerica*, 304 F.3d at 471–72.

[28] *Id.* at 472 (citing other Fifth Circuit decisions requiring arbitration of voidable contracts).

[29] *Id.* at 472–73 (Dennis, J., concurring).

decision.[30] Judge Dennis concluded that based on the facts in the record, he knew of no way the contract could be enforced against the incompetent defendant.[31] Hence, an outcome similar to that of *Spahr* would be inevitable under Judge Dennis's analysis.[32] However, it would be achieved in a more roundabout way—by court review of the arbitration award.[33] Comparing the *Spahr* decision with the *Primerica* opinion, the *Primerica* concurrence, and other arbitrability decisions yields several valuable insights, as discussed in Part IV.

IV. ISSUES RAISED BY THE COURT'S HOLDING AND ANALYSIS THEREOF

Spahr raises several important arbitrability issues. First, *Spahr* may promulgate a possible policy shift with respect to arbitration.[34] Second, *Spahr* may help define future debate and analysis of arbitrability.[35] Finally, although *Spahr* may lead to important answers in the near future, the court did not address many significant arbitrability issues.[36]

A. *Possible Shift in Arbitration Policy*

The most obvious result of the *Spahr* decision is that there is now a split among circuit courts on the arbitrability of contracts challenged by mental incapacity claims.[37] This split leads to the inevitable question of when the U.S. Supreme Court will consider the issue. This question is particularly important given the view by some that there may be a trend by the Supreme

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[30] *Id.* at 473. Under Mississippi law, an arbitration decision is to be vacated if the award is contrary to public policy, is arbitrary and capricious, is in manifest disregard of the law, or is not drawn from the underlying contract. *Id.*

[31] *Id.*

[32] Both analyses appear to require courts eventually to review the merits of the case and, if incapacity is found, refuse to enforce the voidable contract.

[33] It is important to note that this possibly circuitous procedure appears to contradict the FAA's purpose and policy of promoting efficiency. *See* Prima Paint Corp. v. Flood & Conklin Mfg., 388 U.S. 395, 404 (1967) (noting "the unmistakably clear congressional purpose that the arbitration procedure . . . be speedy and not subject to delay in the courts").

[34] *See infra* Part IV.A.

[35] *See infra* Part IV.B.

[36] *See infra* Part V.

[37] *See supra* notes 9–10 and accompanying text.

Court to temper the extremely favorable policy toward arbitration established in *Prima Paint*.[38]

If the policy favoring arbitration is shifting, as possibly initiated by *First Options*, *Spahr* may be an excellent case for the Supreme Court to weaken the tight grip arbitration clauses currently have on parties who sign adhesion contracts.[39] William Spahr's considerable mental incapacity and Melissa Secco's egregious form of fraud would seem to give the Court good reason to adjust the current policy to increase protection for both consumers and employees bound by adhesion contracts.[40] Because of these inequities, the Tenth Circuit's decision could be the necessary catalyst to enable such a shift and allow a reevaluation of current policy and circumstances.[41]

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[38] *See* Prima Paint, 388 U.S. at 403–04 (creating the doctrine of separability, thereby making it extremely difficult for any party to avoid arbitration). *But see* First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 943–45 (1995) (holding that courts, not arbitrators, are to decide on the issue of arbitrability *unless* "clear and unmistakable" evidence indicates that the parties agreed to arbitrate the arbitrability issue); Cole, *supra* note 24, at 28 (questioning whether the Supreme Court's decision in *First Options of Chicago, Inc. v. Kaplan* is consistent with *Prima Paint*). Critics have argued that the origin of the policy, which *Prima Paint* purports is based on the FAA and its legislative history, is not as clear or as strong as put forth in *Prima Paint*. *See* Reuben, *supra* note 7, at 883 (arguing that the policy put forth in *First Options* is actually the appropriate policy supported by the FAA's text and legislative history).

[39] *See* Reuben, *supra* note 7, at 878–83 (discussing the Supreme Court's apparent shift toward requiring actual, instead of implied, consent to uphold arbitration agreements).

[40] *See id.* at 823 (proposing that the procedural safeguards of courts and the efficiency and benefits of arbitration should both be considered and traded off in determining arbitration policy). Reuben also suggests that the doctrine of separability, in particular, no longer has a valid policy-based purpose. *Id.* at 880–81.

[41] *See* Reuben, *supra* note 7, at 880–81 (arguing that *Prima Paint*'s doctrine of separability has served its purpose of deterring judicial hostility towards arbitration, but has "outlived its usefulness"); *see also* Cole, *supra* note 24, at 29–30. However, note that the first and only case to cite to *Spahr* as of March 1, 2004 simply grouped *Spahr* with other cases that fit within the exception to *Prima Paint*. Carbajal v. Household Bank, No. 00 C 0626, 2003 U.S. Dist. LEXIS 16458, at *21 n.6 (N.D. Ill. Sept 18, 2003). The *Carbajal* court stated that the *Spahr* court held the agreement in dispute to be a "nonexistent" contract. *Id.* However, the *Spahr* opinion specifically states that the court reached its conclusion because the void-voidable "distinction is not dispositive" in mental incapacity claims. *Spahr*, 330 F.3d at 1272. *Carbajal*, in summarily categorizing *Spahr*, maintained the void-voidable distinction and the extremely high *Prima Paint* standard required of parties hoping to avoid arbitration. *Carbajal*, 2003 U.S. Dist. LEXIS, at *21–24.

B. *Definition of Arbitrability Issues*

In considering *Spahr* and comparing its reasoning with the reasoning in *Primerica*, at least three questions arise that will likely help define the issue of arbitrability in the near future. First, what rule should be used to determine an arbitration agreement's validity? Second, based on that rule, what is the proper line between sending a case to arbitration and hearing it in court? And third, at what point in a dispute should a court apply this rule?

1. *Rule for Determining Arbitrability*

Before *Spahr*, the criterion for deciding arbitrability issues was becoming well established.[42] Voidable contracts consistently went to arbitration, whereas void contracts generally went to court.[43] The decision in *Spahr* encroached on this voidable contract rule.[44] The *Spahr* court proposed a new rule based on the *in*separability of the arbitration agreement from the rest of the contract when it is challenged on a claim of mental incapacity.[45] In essence, this new rule creates an exception to the doctrine of separability established in *Prima Paint*.[46] In dicta, the *Spahr* court stated that the test for this rule would likely be based on whether an arbitrability challenge were based on the status or the behavior of the parties.[47]

Hence, in proposing this new rule and suggesting a possible test for it, the former rule, requiring voidable-contract challenges to go to arbitration, was called into question, opening the door for other possible rules to take its

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[42] *See supra* note 24 and accompanying text.

[43] *See, e.g.*, Sphere Drake Ins. Ltd. v. All Am. Ins. Co., 256 F.3d 587, 591 591 (7th Cir. 2001); Sandvik AB v. Advent Int'l Corp., 220 F.3d 99, 107 (3d Cir. 2000); Three Valleys Mun. Water Dist. v. E.F. Hutton & Co., 925 F.2d 1136, 1137 (9th Cir. 1991); Cancanon v. Smith Barney, Harris, Upham & Co., 805 F.2d 998, 999 (11th Cir. 1986); I.S. Joseph Co. v. Michigan Sugar Co., 803 F.2d 396, 398 (8th Cir. 1986). Each of these five circuits has refused to require arbitration of void contracts despite the lack of a specific challenge to the arbitration agreement itself; but each *has* required voidable contracts to be arbitrated. Although consensus was being reached, it is notable that the Fifth Circuit has not yet accepted this distinction. *See* Lawrence v. Comprehensive Bus. Servs. Co., 833 F.2d 1159, 1162 (5th Cir. 1987) (requiring arbitration of an entire contract that was illegal). *But see* Primerica Life Ins. Co. v. Brown, 304 F.3d 469, 473 (5th Cir. 2002) (Dennis, J., concurring) (noting that the Fifth Circuit has not specifically addressed the distinction between void and voidable contracts and the authority of other circuits making this distinction).

[44] *Spahr*, 330 F.3d at 1272–73.

[45] *Id.*

[46] *Id.*

[47] *See supra* note 22 and accompanying text.

place.[48] Ensuing uncertainty could eventually lead to the complete demise of *Prima Paint*'s separability rule and the creation of a new rule that mandates less arbitration than the current rule requires. Any rule allowing more civil litigation of claims would better protect the rights of individuals to be heard in court, but would also sacrifice some of the efficiency gained from sending virtually all disputes over contracts containing arbitration clauses to arbitration.[49]

2. *Line Between Arbitration and Court Hearings*

If *Spahr* does lead to a change in the rule for arbitrability, a new line will be drawn, likely decreasing the currently high degree of invalidity required for an arbitration agreement and its accompanying contract to be considered in court.[50] For example, under the current separability rule for which courts send virtually all voidable contract challenges to arbitration, it appears that a contract induced by fraud upon a severely retarded child must still be sent to arbitration.[51] A new rule could change this practice and allow the severely retarded child the right to sue in court, despite the absence of a specific challenge to the arbitration agreement itself. Whatever the rule is, courts may be able to use the *Spahr* opinion to reevaluate the practical effects of any arbitrability rule on individuals and to reconsider the appropriate line for sending cases to court instead of to arbitration.

3. *When to Rule on Arbitrability*

Considering *Spahr*, *Primerica*, and the *Primerica* concurrence together may lead courts to analyze contracts more at the pre-arbitration, injunction stage, instead of merely at the post-arbitration, vacation stage. As noted in

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[48] Although *Spahr* may impact the arbitrability of voidable contracts, the arbitrability of void contracts almost certainly will not be affected, because mental incapacity challenges only claim that a contract is voidable, instead of void.

[49] *See supra* note 40 and accompanying text.

[50] Given the fact that so many cases currently go to arbitration, despite the fact that a party's intent may be absent in many adhesion contracts containing arbitration agreements, it appears that any changes in arbitrability could only move toward allowing more cases to go to court. *See* Reuben, *supra* note 7, at 858–60.

[51] *See supra* note 22 and accompanying text. Although in theory *Prima Paint* makes an exception for contract challenges made specifically against the arbitration agreement itself, in practice there do not appear to be many, if any, adhesion contracts where it can be shown that the arbitration agreement itself was induced by fraud. *See* Cole, *supra* note 24, at 25 (posing the question: "Can you imagine a factual scenario in which a party fraudulently induced a container contract but not the arbitration agreement?").

the concurrence in *Primerica*, a contract made with an incompetent is voidable, and any finding by an arbitrator upholding the contract would be vacated on review as contrary to public policy and in manifest disregard of the law.[52] However, the *Primerica* majority opinion found that to consider the facts of such a case *before* arbitration would be to delve into the merits of the case, instead of considering only the "making" of the agreement, as required by the FAA.[53] Unlike the *Primerica* court, the *Spahr* court sent the case to be tried in the lower court instead of in arbitration based on the incapacity claim and the inequitable facts of the case.[54]

The discrepancy by these courts may lead future courts to reconsider what constitutes analyzing the "underlying" dispute and merits of the case versus merely analyzing the making of the agreement. Additionally, courts may also be led to discuss whether it is even possible to analyze the making of an agreement at all without considering any merits of the case. If not, the two rules must be reconciled. In reconciling these rules, courts will be required to evaluate whether it is better to consider more of the merits of the case during the injunction procedures *or* during the arbitration review procedures.[55] Regardless of the outcome of these analyses, *Spahr* could serve an important role in raising these timing issues for further consideration.

V. CONCLUSION

Perhaps the greatest value of *Spahr* stems from the questions it raises. Until the *Spahr* decision, circuit courts routinely applied *Prima Paint*, sending almost all cases with arbitrability disputes to arbitration without much analysis. *Spahr* may be the impetus necessary to lead other courts to reconsider more closely the current standing of arbitrability and to resolve some of the inconsistencies and policy problems of arbitrability that are facing courts at this time.

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[52] *Primerica*, 304 F.3d at 472–73 (Dennis, J., concurring).

[53] *Id.* at 471–72.

[54] *Spahr*, 330 F.3d at 1273.

[55] The two major policies to consider on this issue are efficiency and fairness. In considering efficiency, courts must balance saving court resources and time (as judges scrutinize motions to enjoin arbitration) against wasting parties' time and resources (as parties argue their case in arbitration only to have a court review and overturn an arbitration decision upholding a voidable contract). *See, e.g.*, Cole, *supra* note 24, at 9–11. In considering fairness, courts must consider the rights of the parties to be heard in court, at least in terms of their making of the agreement, and the intents and positions of the parties in signing their agreements. *See* First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 944–45 (1995); Reuben, *supra* note 7, at 860–62.